Supreme Court of the Unit

October Term, 194

No. 22.

IRVING TRUST COMPANY, as Tem
rupcy of Ontiveros Operating Co

A. W. PERRY, INC.

On Writ of Certiorari to the United States C
Appeals for the Second Circ

Motion and Brief of Amici Curiae in
Reargument

INDEX.

	Page
Motion for leave to file brief as amici curiae	1
Brief of Thomas Hunt and Earle W. Carr as amici curiae in support of respondent	3
Opinions below	3
Statement of facts	3
Question presented	5
Statute involved	5
Summary of argument	7
Argument	8
I. This claim is not a claim for future rent. It is not based upon a covenant to pay rent, but upon a covenant to pay damages upon the ipso-facto termination of the lease by bankruptcy	8
II. The decision in the Manhattan Properties case, while not decisive of the case at bar, strongly supports the provability of this claim	10
III. There is no logical objection to the provability of this claim. The covenant upon which it is based avoids all the defects which have been found in simple rent claims or claims based upon indemnity covenants	15
IV. The legislative history of the Bankruptcy Act in the light of the trend of court decisions shows that Congress intended the instant claim to be provable	18
V. It is not contrary to the provisions of the Bankruptcy Act for parties to make a contract out of which a claim provable in bankruptcy may arise even though without the contract there would be no provable claim	23

Page

VI. The covenant in the instant case liquidates the damages upon a footing that is familiar and fair 27

VII. The 1934 amendments to section 63 of the Bankruptcy Act have no tendency to show that prior to such amendments Congress intended that claims based on ipso-facto covenants should not be provable 30

Conclusion 33

TABLE OF AUTHORITIES CITED.

Cases.

Atkins v. Wilcox, 105 Fed. 595 25

B. & O. R. Co. v. Baugh, 149 U.S. 368 22

Bowman Hotel Corporation, 24 B.T.A. 1193 29

Brown v. Irving Trust Company, 66 Fed. (2d) 473 24

Brown et al. v. Irving Trust Co., 291 U.S. 320 10

Central Trust Co. v. Chicago Auditorium Association, 240 U.S. 581 27, 29

Dodds v. Hakes, 114 N.Y. 260 29

Gardiner v. Butler & Co., 245 U.S. 603 9

Henri Pauchey & Son, Inc., 22 B.T.A. 774 29

Hotel Waldorf Co., 22 B.T.A. 430 29

Kothe v. Taylor Trust, 280 U.S. 224 21

Lake, Ex Parte, Fed. Cas. 7991 20, 24

Manhattan Properties, Inc., v. Irving Trust Company, 291 U.S. 320
4, 7, 8, 9, 10, 13, 14, 15, 16, 17, 18, 19, 24, 31, 32

Marshall's Garage, In re, 63 Fed. (2d) 759 29

Neal v. Jefferson, 212 Mass. 517 29

Roth & Appel, In re, 181 Fed. 667 11, 16, 21, 24

Slocum v. Soliday, 183 Fed. 410 16

Twentieth Century Millinery Exchange, Inc., In re, 41 Fed. (2d) 237 19

Page

Union Co., The, v. United States, 46 Fed. (2d) 717 29
Watson v. Merrill, 136 Fed. 359 9
Wisconsin Engine Co., In re, 234 Fed. 281 25, 26
Wm. Filene's Sons v. Weed et al., 245 U.S. 597 16, 28
Wright v. Irving Trust Co., 70 Fed. (2d) 245 14

STATUTES.

Act of July 1, 1898, secs. 1, 17 and 63, 30 Stat. 562, as amended, U.S.C.A. Title 11, secs. 1, 35 and 103 6
Bankruptcy Act, sec. 1 (11) 6
Bankruptcy Act, sec. 17 6
Bankruptcy Act, sec. 63 5, 6, 8, 15, 33
Bankruptcy Act, sec. 63 (7) 30, 32, 33
Bankruptcy Act, sec. 63 (a), 1, 4 19
Bankruptcy Act, sec. 63 (a) 4 22

TEXTS.

Williston on Contracts, vol. III, sec. 1405 29

In the

Supreme Court of the United States.

October Term, 1934.

No. 22.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC.,
Petitioner,
v.
A. W. PERRY, INC., *Respondent.*

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

Now come Thomas Hunt and Earle W. Carr, and move this Honorable Court for leave to file the annexed brief as *amici curiae,* the consent in writing of counsel for the petitioner and of counsel for the respondent having first been obtained. The undersigned ask this leave as counsel for Frederic E. Snow and Sidney E. Shuman, Trustees of the A. Shuman Real Estate Trust, who filed a claim in the United States District Court for the Southern District of New York in bankruptcy proceedings entitled: "In the Matter of Louis K. Liggett Company, Bankrupt—In Bankruptcy No. 56,900." This claim is based on a clause in a lease identical with that contained in the lease involved in this case, except that the *ipso facto* termination of the lease was accomplished by the adjudication of the bank-

ruptcy of the lessee rather than by the filing of the petition. Judge Knox held that this claim was provable in an order entered May 18, 1934, relying upon the decision of the United States Circuit Court of Appeals for the Second Circuit which this Court is now reviewing. Counsel for the Trustees in Bankruptcy of the Louis K. Liggett Company have heretofore filed a brief as *amici curiae*.

THOMAS HUNT,
EARLE W. CARR,
Office and Post Office Address,
82 Devonshire Street, Boston, Mass.

Boston, Mass., September 28, 1934.

In the

Supreme Court of the United States.

October Term, 1934.

No. 22.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC., *Petitioner,*

v.

A. W. PERRY, INC., *Respondent.*

BRIEF OF THOMAS HUNT AND EARLE W. CARR AS AMICI CURIAE IN SUPPORT OF RESPONDENT.

Opinions Below.

Neither the opinion of the Referee (R. 13-23) nor the opinion of the District Court (R. 26) is reported. The opinion of the United States Circuit Court of Appeals (R. 31-34) is reported in 69 Fed. (2d) 90.

Statement of Facts.

The respondent, A. W. Perry, Inc., leased in 1929 to the bankrupt Outfitters Operating Realty Co., Inc., certain premises at No. 459 Washington Street, Boston, Massachusetts, for a term ending December 31, 1944, at a specified

progressive rental (R. 6-11).

The lease contained the following clause (R. 10):

> ". . . and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The bankrupt filed a voluntary petition in bankruptcy in the United States District Court for the Southern District of New York on September 30, 1932, and was adjudicated bankrupt the same day (R. 1).

On March 29, 1933, the respondent filed a claim in the sum of $177,788, based on the provision of the lease above quoted (R. 4-11). The petitioner moved to expunge the claim and a hearing was had before the Referee at which it was stipulated that the objection there raised was solely to the provability of the claim, the question of the amount being reserved (R. 12, 13).

The claim was expunged by the Referee (R. 13-23), and his order was affirmed by the District Court (R. 26-27). However, the Circuit Court of Appeals reversed both the Referee and the District Court and held that the claim was provable (R. 31-35). The opinion by L. Hand, J., stated that this court had held in *Manhattan Properties, Inc.*, v.

Irving Trust Company, 291 U.S. 320, that claims for future rent are ordinarily not provable, and can become so, if at all, only by virtue of special clauses; that the question of the validity of such a clause as that used in the instant case had been specifically reserved by this Court; that the clause in the instant case avoided the uncertainties that had made other clauses ineffective, since the claim was not contingent either in right or in amount at petition filed. Therefore the claim was held provable and the covenant was interpreted as providing for damages consisting of the sum of a discounted series of installments, each made up of the rent reserved, less the fair rental value for that period.

Question Presented.

Does respondent have a claim provable in bankruptcy under section 63 of the Bankruptcy Act based upon the special clause used in the instant case?

Statute Involved.

Section 63 of the Bankruptcy Act, as applicable to this case, provides:

> "Debts which may be proved.—a. Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (4) founded upon an open account, or upon a contract express or implied; * * *

"b. Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

Section 1 (11) provides:

"'debt' shall include any debt, demand, or claim provable in bankruptcy."

Section 17 provides:

"A discharge in bankruptcy shall release a bankrupt from all of his provable debts, * * *"

with exceptions not here material (Act of July 1, 1898, sections 1, 17 and 63, 30 Stat. 562, as amended, U.S.C.A. Title 11, sections 1, 35 and 103).

On June 7 and 18, 1934, section 63 was amended by adding the following sub-sections, which have no bearing on this case except in so far as they tend to disclose the intent of Congress with respect to the meaning of section 63 prior to these amendments.

"(6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary; and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a

corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided Further That the provisions of this clause (7) shall apply to estates, pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

Summary of Argument.

This claim is not a claim for future rent. It is for liquidated damages based on a clause in the lease which automatically terminated the lease (and therefore the lessee's liability to pay rent) on the filing of the petition in bankruptcy by the lessee and contemporaneously raised an obligation to pay the damages thereby suffered.

This Court in the recent case of *Manhattan Properties, Inc.*, v. *Irving Trust Company*, 291 U.S. 320, recognized the distinction between claims based on covenants to pay *rent* on the one hand and claims based on clauses like the one here involved, holding the former not provable and specifically reserving the question of the provability of the latter. The reasoning used by this Court in arriving at its decision in the Manhattan Properties case strongly supports the provability of the instant claim.

There is no logical objection to the provability of this claim. It is certain in obligation and amount at petition filed.

There is no historical foundation for holding the claim not provable; on the contrary, the failure of Congress to amend section 63 of the Bankruptcy Act in the face of strongly expressed dicta that claims like the instant one would be provable is strong evidence that such dicta correctly interpreted the legislative intent.

The 1934 amendments to section 63 of the Bankruptcy Act show that Congress considered that claims like the instant one were provable before such amendments.

It is proper for the parties to a lease to insert special covenants therein which give the lessor a provable claim in bankruptcy even though without such provisions the lessor would have no provable claim to compensate him for his loss of rents.

The covenant in the instant case liquidates the damages upon a footing that is familiar and fair.

Argument.

I. This claim is not a claim for future RENT. *It is not based upon a covenant to pay rent, but upon a covenant to pay damages upon the ipso-facto termination of the lease by bankruptcy.*

It is necessary at the outset to place emphasis upon this obvious fact because of the distinction which exists between covenants to pay rent and covenants such as the one upon which this claim is based. It is a matter, not of phraseology, but of substance. The petitioners in *Manhattan Properties, Inc.*, v. *Irving Trust Co.*, 291 U.S. 320, strenuously urged that there was no sound reason consistent with the purposes of the Bankruptcy Act why any distinction should be made between the claim of a landlord for future rent and claims

founded on any other executory contract. This Court rejected that broad contention and recognized the effect in bankruptcy of the technical law as to leases, which, as this Court remarked in *Gardiner* v. *Butler & Co.*, 245 U.S. 603, is not a matter of logic *in vacuo* but a matter of history that has not forgotten Lord Coke.

The proof of claim filed contains the following rather inaccurate language (R. 5):

> ". . . that the consideration of said debt is as follows: Damages for breach of covenant to pay rent under a lease, a copy of which is hereto annexed . . ."

In a brief filed in this case by Walter H. Hope and H. Struve Hensel as *amici curiae* it is urged (p. 8) that this claim is not provable on its face, because of the above-quoted language in the proof of claim. Of course respondent is not bound by the descriptive language used in its proof of claim. In *Watson* v. *Merrill* (C.C.A. 8th), 136 Fed. 359, the court said (p. 360):

> "It is, however, the nature of the claim, and not the name which is applied to it, that conditions its provability in bankruptcy."

This case was decided below and is argued here by the petitioners as a claim based on the ipso-facto covenant. Whether there is sufficient difference between a simple covenant to pay rent and the ipso-facto clause and covenant in the lease here involved to permit a provable claim to be founded on the latter is the point before this Court for determination; it serves only to obscure the issue to seize upon inaccurate language in the proof of claim as an admission that the claim is for damages for breach of a covenant to pay rent and therefore not provable under the decision in the Manhattan Properties case, *supra.*

II. The decision in the Manhattan Properties case, while not decisive of the case at bar, strongly supports the provability of this claim.

Consideration of this case starts logically with the latest decision of this Court on the subject, *Manhattan Properties, Inc.*, v. *Irving Trust Co.* and *Samuel R. Brown et al.* v. *Irving Trust Co.*, 291 U.S. 320.*

This decision involved two claims. The first claim was based on a lease which had about five years and a half to run at the time the lessee was adjudicated bankrupt in an involuntary proceeding. The lease contained a covenant that, if bankruptcy proceedings were instituted by or against the tenant, the landlord might re-enter and relet as agent for the tenant and—

> "The Tenant further agrees to pay each month to the Landlord the deficit accruing from the difference between the amount to be paid as rent as herein reserved and the amount of rent which shall be collected and received from the demised premises for such month during the residue of the term herein provided for after the taking possession by the Landlord; the overplus, if any, at the expiration of the full term herein provided for shall be paid to the Tenant unless the Landlord within a period of six months from the termination of this lease as provided herein shall, by a notice in writing, release the Tenant from any and all liability created by this provision of the lease, which it is agreed the Landlord shall, at the Landlord's option, have the right to do, in which event it is agreed that the Landlord and the Tenant shall have no further rights and liabilities hereunder."

* These two cases were argued and decided together. The decision is referred to elsewhere in this brief for convenience by the title of the first case or simply as the Manhattan Properties case.

The lessor filed a claim for $25,000 damages for loss of future rentals, computing the amount by subtracting the present rental value of the leased premises from the rent reserved in the lease for the balance of the term.

The second claim was based on a lease which had about twelve years and nine months to run at the time the lessee was adjudicated bankrupt upon its voluntary petition. The lease contained a covenant that, if the lessee were adjudicated bankrupt, the lessor might enter—

> ". . . and upon entry as aforesaid this lease shall determine, and the Lessee covenants that in case of such termination it will indemnify the Lessor against all loss of rent which the Lessor may incur by reason of such termination, during the residue of the term above specified."

The lessor filed a claim which contained an item of $4404.40 representing the difference between the rent accrued to the date of re-entry and collections from occupants during the period and an item of $143,615.80 representing the difference between the alleged rental value for the remainder of the term and the rent reserved in the lease.

The opinion of this Court, after stating the facts and quoting the applicable sections of the Bankruptcy Act, noted that a majority of the Circuit Court of Appeals had felt bound to follow its earlier decision, *In re Roth & Appel*, 181 Fed. 667. The reasons relied on in that opinion were reviewed. The Court then stated the equitable grounds which had been urged both for and against the provability of future rent claims. It was conceded that the construction of the Bankruptcy Act for which the lessors contended was logically an admissible one, but that the sole inquiry was the intent of Congress. The Court then made a careful inquiry into the legislative history of the present Bank-

ruptcy Act and its predecessors in the light of the court decisions. It was found that the lower federal and state courts had considered future rent claims not provable under the Bankruptcy Acts of 1800, 1841 and 1867 and that no provision for future rent claims was made in the Act of 1898. After the passage of the Act of 1898 it was noted that the great majority of the lower federal courts, including the Circuit Courts of Appeals in six circuits, had held that future rent claims were not provable under the Act of 1898. During the period between 1898 and 1932 the Bankruptcy Act was amended eight times without alteration of section 63 (a). This Court then concluded that the construction of the statute so long and so generally accepted was highly persuasive that the construction of the courts correctly interpreted the intent of Congress. Therefore this Court approved the great weight of lower-court authority holding that future rent claims were not provable.

The Court then passed to consideration of the effect of the specific indemnity covenants contained in the two leases. It was pointed out that they did not provide for liquidation of damages and that they became effective only on optional re-entry by the lessor. These defects were held to be fatal to the provability of the claims. The Court concluded with this statement (p. 338):

> "There can be no debt provable in bankruptcy arising out of a contract which becomes effective only at the claimant's option and after the inception of the proceedings, the fulfilment of which is contingent on what may happen from month to month or up to the end of the original term. Compare In re Ells, supra; Slocum v. Soliday, supra; In re Roth & Appel, supra. Such a covenant is not, as petitioners contend, the equivalent of an agreement that bankruptcy shall be a breach of the lease and the consequent damages to

> the lessor be measured by the difference between the present value of the remainder of the term and the total rent to fall due in the future. The covenants appearing in the leases in question cannot be made the basis of a proof of debt against the estate."

The decision of this Court in the Manhattan Properties case falls logically into two parts:

(1) Claims founded upon covenants to pay future rent are not provable in bankruptcy.

(2) The specific indemnity covenants contained in the leases in that case were not sufficient to support provable claims.

Petitioner endeavors to merge these two points by saying (p. 12):

> "It is manifest, therefore, that regardless of the scope of the precise holding in the Manhattan Properties case, this Court had no intention of distinguishing generically between claims for future rent and claims for damages for breach of rent covenants, nor is there any basis in the history of the doctrine, as is manifest from the opinion itself, to justify a distinction."

If by "rent covenants" petitioner means covenants to pay rent, the statement is of course correct, but inapplicable to the claim involved in this case, because the covenant here concerned is not a covenant to pay rent at all, but a covenant to pay damages which does not come into operation until the lease has been terminated by the ipso-facto clause. On the other hand, if petitioner intends "rent covenants" to be broad enough to include a covenant which has no connection with rent other than the fact that its purpose is to secure the lessor against loss of rents, it is submitted that this Court did intend to distinguish gener-

ically between claims for future rent and claims for damages for breach of such covenants.

If this Court intended to hold in the Manhattan Properties case that there could be no distinction between claims for future rent and claims based on special covenants, the critical examination of the covenants in the last pages of the Court's opinion would have been superfluous. It is obvious that this Court considered the two points decided separate and distinct from the transitory sentence used when passing from consideration of the provability of future rent claims in general to consideration of the specific covenants (p. 337).

> "It *remains* to consider the effect of the indemnity covenants in the leases." (Italics supplied.)

L. Hand, Circuit Judge, correctly described the scope and effect of the Manhattan Properties decision in the opinion below (R. 31, 32):

> "Meanwhile the Supreme Court on February 5, 1934, affirmed our decision in Manhattan Properties v. Irving Trust Co., and has thus finally settled it that claims for future rent are not ordinarily provable, and can become so, if at all, only by virtue of special clauses. The question here is whether this clause will serve; its possible validity was specifically reserved in the Supreme Court's opinion."

The Circuit Court of Appeals for the Second Circuit announced in *Wright* v. *Irving Trust Co.*, 70 Fed. (2d) 245, 246, that it interprets the Manhattan Properties opinion as indicating that provable claims may arise under leases if the obligation be certain in both event and amount at petition filed:

"However, we have twice already held that provable claims may arise under leases, *if the obligation be certain in both event and amount at petition filed.* In re Outfitters' Operating Realty Co. (A. W. Perry, Inc. v. Irving Trust Co.) (C.C.A.) 69 F. (2d) 90; Winston-Salem Masonic Temple Co. v. Irving Trust Co. (C.C.A.) 69 F. (2d) 484. Part of the discussion in Manhattan Properties, Inc. v. Irving Trust Co., supra, 290 U. S. —, 54 S. Ct. 385, 78 L. Ed.—, certainly gives color to that notion, and we shall take it as the proper test, until the Supreme Court decides otherwise." (Italics supplied.)

It is submitted that the court below has correctly interpreted and applied the decision of this Court in the Manhattan Properties case.

III. There is no logical objection to the provability of this claim. The covenant upon which it is based avoids all the defects which have been found in simple rent claims or claims based upon indemnity covenants.

The determination of what claims are provable under section 63 of the Bankruptcy Act is ultimately one of determining the intent of Congress. This Court determined the intent of Congress with respect to the claims involved in the Manhattan Properties case largely on a historical basis —the legislative evolution of the Bankruptcy Laws in the light of the court decisions on the subject known to Congress when amendments were made. The bearing of such an analysis on the claim to be adjudicated in this case is considered hereafter in this brief. It is here urged that none of the reasons which have been advanced by the courts in holding claims based on rent or indemnity covenants not provable are applicable to the instant case.

The most frequently expressed reason for holding future rent claims not provable is the doctrine traceable to Lord Coke that rent is the consideration for the actual use and enjoyment of land and is deemed to come out of the profits of the estate. *Wm. Filene's Sons* v. *Weed*, 245 U.S. 597, 601. Consequently, until the time for payment arrives, the rent is not only not yet payable, but there is no debt or obligation whatever. True, there may be a debt in the future, but if for any reason the right to occupy should terminate, the obligation to pay would cease. Hence it was held that, if the tenant became bankrupt, the landlord had no claim for unaccrued rent, because of the uncertainty as to whether there would ever be any obligation to pay.

In re Roth & Appel, 181 Fed. 667 (C.C.A. 2).
Slocum v. *Soliday*, 183 Fed. 410 (C.C.A. 1).
Manhattan Properties, Inc., v. *Irving Trust*, 291 U.S. 320.

This is a defect that necessarily inheres in covenants to pay future rent, but only in covenants to pay *rent*. In order for a lessor to have a provable claim against his lessee, all that is necessary is that there be sufficient certainty about the obligation at the time of bankruptcy.

Under the provision of the lease relied upon in this case the lessor's claim is fully matured and absolutely due and owing at the time the petition in bankruptcy was filed. The provision operated as a conditional limitation terminating the lease without entry or other action by the lessor. The obligation imposed upon the lessee by the clause to pay damages cannot be an obligation to pay rent, because the lease is gone. Rent reserved and covenants to pay rent do not survive the termination of the lease, yet this covenant becomes operative only upon the termination of the lease. The distinction between claims based on covenants to pay future rent and a claim based upon a promise by the lessee to pay

damages upon the termination of the lease *ipso facto* upon his going into bankruptcy is thus a vital one. The uncertainty that prevents a provable claim being founded on a covenant to pay *rent* is not found in a clause which operates to terminate the lease *ipso facto* as a conditional limitation and raises an obligation to pay *damages* for the reason that the uncertainty arises out of the technical law relating to rents, which therefore applies only to covenants to pay *rent*, and not to any other covenants, even though those covenants are intended to secure the lessor against loss of rents.

Lessors have tried various forms of special covenants in an attempt to give them a standing to prove their damages in the event of the lessee's bankruptcy. Two principal defects have been found by the courts in most of the covenants which have been used:

(1) They have been based upon a right of entry by the landlord.

(2) They have been indemnity covenants requiring the lessee to indemnify the lessor against actual loss suffered on reletting.

These defects caused the claim of the lessor to be uncertain both in obligation and amount at the time of filing the petition. It was uncertain at that time whether the lessor would elect to re-enter, and it was uncertain whether, if he did re-enter, he would suffer any loss. Since the covenant was to *indemnify* against actual loss, it was necessary to await the end of the term to determine it. These defects were fatal, since, as this Court stated in the Manhattan Properties case, *supra* (p. 338):

> "There can be no debt provable in bankruptcy arising out of a contract which becomes effective only at the claimant's option and after the inception of the proceedings, the fulfilment of which is contingent on what may happen from month to month or up to the end of the original term."

The clause upon which the present claim is based avoids both these difficulties. It operates, not on entry at the election of the lessor, but *ipso facto* as a conditional limitation immediately upon the filing of the petition in bankruptcy. Furthermore, it is not an *indemnity* covenant which requires awaiting the end of the term to ascertain actual loss, but a *damage* covenant which may be liquidated at a definite amount based only on facts readily determinable at the time of bankruptcy, viz., the rent reserved in the lease for the remainder of the term and the fair rental value of the premises at that time.

IV. The legislative history of the Bankruptcy Act in the light of the trend of court decisions shows that Congress intended the instant claim to be provable.

This Court in the Manhattan Properties case, *supra,* decided the general question of the provability of future rent claims in the absence of special covenants on a historical basis. The equitable considerations which it is possible to urge on both sides were reviewed, and it was conceded that a logical case could be made for provability. However, the question was reduced to an inquiry into the intent of Congress. Since the weight of the lower-court decisions had been heavily against the provability of such claims and Congress had amended the Bankruptcy Act many times without alteration of the section defining provable debts, it was held that the construction adopted by the courts had been acceptable to the legislative arm of the Government.

A similar analysis of the court decisions and dicta dealing with claims based on special covenants in leases as distinguished from simple covenants to pay rent leads to the conclusion that Congress intended claims based upon properly drawn covenants to be provable.

The historical foundation for the provability of damage claims against lessees based on ipso-facto covenants starts with the significant fact that no case has been found (other than the overruled decision of the District Court below) which holds not provable a claim based on a covenant substantially similar to the instant one. This is in direct contrast to the dozens of square holdings relied on by this Court in the Manhattan Properties case that future rent claims based on leases not containing such clauses are not provable.

On the other side, it must be admitted that there is a dearth of square holdings that claims based on ipso-facto damage clauses are provable. The only actual decision found (other than the decision below) is *In re Twentieth Century Millinery Exchange, Inc.*, 41 Fed. (2d) 237 (D.C. S.D. N.Y.). In this case the bankrupt leased from one Charles Ulin certain premises by a lease which provided that, if the lessee be adjudicated a bankrupt or if a petition in bankruptcy be filed by the lessee—

> "Such event shall be deemed to constitute a breach of this lease and thereupon, *ipso facto* and without entry or without other action by the lessor, this lease shall become and be terminated."

The bankrupt subleased to the claimant at a lower rental, the sublease containing a covenant that, if the bankrupt committed any breach of the original lease requiring the claimant to pay the full amount of rent reserved in the original lease, then the bankrupt should be obligated to pay the claimant the difference between the rent reserved in the original lease and that reserved in the sublease. The court held the claim provable under subdivisions 1 and 4 of the Bankruptcy Act, sec. 63 (a). Perhaps this decision may be limited to its special facts.

However, many of the leading decisions which established the non-provability of claims based on simple covenants to

pay rent or on special covenants not creating a certain obligation at the date of bankruptcy definitely indicate the manner in which covenants could be drawn so that the lessor would have a provable claim.

In *Ex Parte Lake*, Fed. Cas. 7991 (D. Mass. 1877), Judge Lowell held that even under the Act of 1867 the lessor had no provable claim under a covenant which provided that, upon re-entry by the lessor, the lessee—

> "* * * shall remain for the residue of said term responsible for the rent and taxes herein reserved, and shall be credited for such amounts only as shall be by the lessors actually realized."

However, Judge Lowell remarked significantly:

> "If the contract were a little different and provided merely that the lessees should pay any loss or damage consequent upon the diminished value of the premises, the amount would be capable of ascertainment with sufficient certainty. * * * But I am unable to reach the conclusion that the stipulation in this case is calculated to work out the result. It seems to provide that the lessees, after a breach shall remain liable for the rent precisely as before, excepting that they are to be credited with any sums actually received for the use of the premises. This brings the case unfortunately within the numerous decisions concerning rent, which, not accruing at once, cannot be estimated beforehand."

It requires little imagination to see that Judge Lowell was sympathetic with lessors whose claims were barred by the technical law relating to rent and that he would have held the claim provable if the covenant had been "a little different."

The leading early decision on the subject cited and relied upon in almost all subsequent cases dealing with the subject is *In re Roth & Appel,* 181 Fed. 667 (C.C.A. 2.). The claim in this case was based on a covenant which gave the lessor a right to re-enter on the bankruptcy of the lessee and recover the difference between the rent reserved and the rent which the lessor was actually able to obtain on reletting. The court held the claim not provable because of the uncertainty as to whether the lessor would re-enter and the uncertainty as to whether there would be a loss if he did. After discussing these defects the court said (p. 671):

> "Undoubtedly the parties to a lease may agree that bankruptcy shall terminate it, and that, upon such termination, all future installments of rent shall at once become due and payable. In such a case, the installments may be regarded as consolidated by the contract, or, perhaps, as falling due by way of penalty. *Not improbably claims based upon such leases are provable in bankruptcy.*" (Italics supplied.)

Could the court have more clearly indicated its belief that a provable claim could be founded upon a properly drawn covenant?

In *Kothe* v. *Taylor Trust,* 280 U.S. 224, the lease contained a clause as follows:

> "The filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

The Referee and District Court disallowed the claim on the general ground that damages for the amount of unaccrued rent are not provable, but the Circuit Court held the claim allowable under section 63 (a) 4, of the Bankruptcy Act. In the Supreme Court the trustee argued that the claim was not allowable because the covenant required the payment of the full amount of the rent, and therefore was equivalent to the imposition of a penalty unrelated to the actual damage sustained by the lessor, since, if the claim were allowed, the lessor would get back his premises and also his rent.

The Supreme Court sustained this argument and reversed the court below *solely* on the ground that the provision for damages was unreasonable. It seems highly improbable that the Supreme Court would have decided the case on the ground that an improper measure of damages had been specified unless it felt that, but for the damage question, the claim was provable, particularly when the case had been decided below on the general question of the provability of the claim.

If Congress is chargeable with notice of the decisions of the courts expunging claims for future rents, it is likewise chargeable with notice of the clearly expressed dicta that the lessor could protect himself by using a clause substantially similar to the one used by the lessor in the instant case. There is not only no historical background of decisions adverse to the logically admissible construction of the statute contended for by the respondent, but the dicta and implications of the relevant decisions are favorable to that construction. The fact that Congress did not amend the Bankruptcy Act to change the construction clearly forecast by these court decisions, although the Act was many times amended in other respects, is persuasive that the judicial construction was acceptable to Congress.

B. & O. R. Co. v. *Baugh,* 149 U.S. 368, 372.

V. It is not contrary to the provisions of the Bankruptcy Act for parties to make a contract out of which a claim provable in bankruptcy may arise even though without the contract there would be no provable claim.

It would seem a waste of time of this Court to set forth such an obvious proposition but for the fact that the contrary is strenuously urged by the petitioner and *amici curiae.*

The petitioner states (p. 4) that the first question presented in this case is:

> "Can a landlord and tenant turn an otherwise non-provable claim into a provable claim merely by stipulating that, in the event of the bankruptcy of the tenant, the lease shall ipso facto terminate and the tenant thereupon be liable to pay liquidated damages?"

Similarly, point II of a brief filed by Walter E. Hope and H. Struve Hensel as *amici curiae* (p. 12) is:

> "The instant claim can not be made provable, contrary to the Bankruptcy Act, by an agreement between claimant and the bankrupt."

It is respectfully submitted that this form of stating the question at issue begs the question. Of course, if we start with the premise that the clause is contrary to the Bankruptcy Act, it cannot be made the basis of a provable claim. The question is simply whether, under section 63 of the Bankruptcy Act, respondent has a provable claim. There is no question of violating any provision of the Bankruptcy Act or of baldly stipulating that a non-provable claim should nevertheless be provable.

This argument in a circle is probably the result of failing to distinguish between claims for future rent and dam-

age claims based on special covenants, and therefore mistaking the scope and effect of the decision of this Court in the Manhattan Properties case.

The *amici curiae* on behalf of petitioner, referred to above, on page 15 of their brief endeavor to reduce the ipso-facto covenant in the instant case to an absurdity by stating that it is equivalent to a provision that—

> "In the event of the filing of a bankruptcy petition against the lessee, the lessor shall have a provable claim in the amount of $177,788."

The brief then proceeds with a series of questions, the burden of which is: "Can the parties stipulate what claims shall be provable or is the statute to define the types of provable claims?"

Obviously, the parties to a contract cannot write the Bankruptcy Law. But they can make a valid contract, the terms of which will create obligations which would not exist had the contract not been made and upon which a claim provable in bankruptcy may be based, although without the contract obviously there would have been no provable claim.

The parties to the lease involved in the instant case did not endeavor to alter section 63 of the Bankruptcy Act. They endeavored to create by contract an obligation which would be sufficiently certain in obligation and amount to fall within the terms of section 63. In doing this they followed the suggestions which had been made by Judge Lowell in *Ex Parte Lake, supra,* and by the Court of Appeals for the Second Circuit in *In re Roth & Appel, supra.*

In *Brown* v. *Irving Trust Company,* the companion case to the Manhattan Properties case, L. Hand, J., in delivering the opinion for the Court of Appeals, said (66 Fed. (2d) 473):

> "The claimant next argues that in case of bankruptcy it could not have been the purpose to reserve a claim or a series of claims in the future against a bankrupt corporation, and that for this reason the promise should be construed as one for liquidated damages. If the only condition of reentry had been bankruptcy, more could be said for this, though hardly enough in view of the terms chosen; but under this lease the lessor might reenter for any breach of covenant, and some of these might occur while the lessee was amply able to respond. If in those events the promise was to indemnify the lessee seriatim, or at the end of the term, we can not recast the condition to make them over into a liquidation of damages in the case of bankruptcy. *Possibly the full intent was not expressed; if so, the loss must fall upon the lessor, who presumably drafted it.*" (Italics supplied.)

Are the lessors who have been unable to prove claims for their losses on the bankruptcy of their lessees because of their faulty draftsmanship to be met, when they do succeed in drafting an efficient clause, with the charge that they are improperly subverting the Bankruptcy Act?

The contention that the parties in the instant case are merely endeavoring to stipulate that an unprovable debt shall be provable is set forth in a slightly different form in petitioner's brief, p. 20 ff., and supported by reference to the cases of *In re Wisconsin Engine Co.*, 234 Fed. 281, and *Atkins* v. *Wilcox*, 105 Fed. 595. These cases dealt with the provability in bankruptcy of claims based on unmatured notes. The notes in the Wisconsin Engine Co. case were given pursuant to a patent license agreement, while those in *Atkins* v. *Wilcox* were given for future rent. The claim based on the rent notes was held not provable and the claim based on the notes for royalties under the patent license

agreement was held provable. The court remarked in the Wisconsin Engine Co. case:

> "While the mere giving of notes to evidence or in prepayment of a clearly conditional obligation would not annul the condition or make an otherwise unprovable claim allowable in bankruptcy (Atkins v. Wilcox, 105 Fed. 595, 44 C. C. A. 626, 53 L. R. A. 118), the provision that notes should be given and that they should be negotiable is additional evidence tending to resolve any doubt as to the intention of the parties that the amount therein stated was to be payable in any event."

Petitioners go on to say (p. 22):

> "We submit that the signing of the notes was as much an express covenant to pay as the language contained in the lease at bar. Yet the test adopted in the two cases just cited was one of type and not of promise. Where there was not involved a non-provable type of claim, the promise contained in the notes was enforced. Where the case did involve a non-provable type, the promise was not enforced, the court pointing out in the Wisconsin Engine case that the giving of notes 'would not * * * make an otherwise unprovable claim allowable in bankruptcy' (p. 284)."

The petitioners in this argument neglect a vital part of the clause upon which the claim in the instant case is based. It includes not only a covenant to pay liquidated damages, but a provision for *ipso-facto* termination of the lease on bankruptcy. It is this conditional limitation which, by terminating the lease, removes the contingency in the obligation, *i.e.*, makes the covenant a promise to pay presently ascertainable damages, and not a covenant to pay rent.

Of course merely repeating a promise to pay rent, whether in the lease itself or on a separate piece of paper, would not create a provable claim. But that is not what the landlord and tenant did in this lease. They changed the *subject-matter* of the promise. When the bankruptcy petition was filed, liability under the covenant to pay *rent* ceased, and liability under the covenant to pay liquidated damages arose.

There is nothing improper about making a contract under which liability can arise only in event of bankruptcy. In the leading case of *Central Trust Co.* v. *Chicago Auditorium Association*, 240 U.S. 581, this Court held that bankruptcy constituted an anticipatory breach of contract to transport baggage, saying (p. 591):

> "In short, it must be deemed an implied term of every contract that the promisor will not permit himself, through insolvency or acts of bankruptcy, to be disabled from making performance; and, in this view, bankruptcy proceedings are but the natural and legal consequence of something done or omitted to be done by the bankrupt, in violation of his engagement" (240 U.S. at 591).

If the courts will *imply* a provision that the promisor will not go into bankruptcy, surely it is competent for the parties expressly to contract for liability conditioned upon the promisor going into bankruptcy.

VI. The covenant in the instant case liquidates the damages upon a footing that is familiar and fair.

The measure of damages specified in the lease is (R. 10):

> "* * * an amount equal to the amount of the rent reserved in this lease for the residue of the term

hereof less the fair rental value of the premises for the residue of said term."

The case of *William Filene's Sons Co.* v. *Weed et al.*, 245 U.S. 597, shows that there is no difficulty in computing the damages under a provision such as the one in the instant lease. In that case this Court permitted proof in receivership proceedings of a claim based upon a covenant by the lessee to pay the lessor as damages the difference between the rental value of the premises and the rent and other payments specified in the lease for the remainder of the term. The fact that this was a receivership instead of a bankruptcy case does not affect it as an authority for the proposition that damages for breach of the covenant in the instant case may readily be determined. Mr. Justice Holmes stated (p. 602):

> "The rest of the claim is for damages ultra the twenty thousand dollars a year—the difference between the rental value at the date of entry and the rent reserved, less the amount received under the twenty thousand dollar clause. This also was contracted for and we see no reason why it should not be paid. The contract was not that all the rent for the term should become presently due, it was not for rent at all, but was a personal covenant that liquidated the damages upon a footing that was familiar and fair."

There is no practical difficulty in reducing respondent's claim to dollars and cents. The liquidation of the claim involves the determination of only one fact—the fair rental value of the premises at the date of bankruptcy. The obvious and common way to make this determination is by means of the testimony of real-estate experts familiar with the property and similar properties. The property has been

leased again for a part of the remaining term. The rentals secured under this lease will provide very good evidence of the value of the entire term. Courts have in general found no difficulty in ascertaining the value of leaseholds. It is a common question arising in breach of contract and tax cases. See, for example:

Neal v. *Jefferson,* 212 Mass. 517.
Dodds v. *Hakes,* 114 N.Y. 260.
Williston on Contracts, vol. III, sec. 1405.
Henri Pauchey & Son, Inc., 22 B.T.A. 774.
Hotel Waldorf Co., 22 B.T.A. 430.
The Union Co. v. *United States* (Ct. Clms.), 46 Fed. (2d) 717.
Bowman Hotel Corporation, 24 B.T.A. 1193.

It has never been suggested that courts were unable to value estates in fee simple. It has been done on countless contract, tax and condemnation cases. Valuation of the fee is simply an estimate of the present value of all future fruits of ownership. Bankruptcy courts have no difficulty in doing this. *In re Marshall's Garage,* 63 Fed. (2d) 759. The valuation of leasehold is merely an estimate of the same thing for a shorter period.

Surely the bankruptcy court is not so impotent as to be unable to determine such a simple fact as the fair rental value of this property for the residue of the term. The problem is less difficult than the valuation of a cab privilege, which was required in *Central Trust Co.* v. *Chicago Auditorium,* 240 U.S. 581.

VII. The 1934 amendments to section 63 of the Bankruptcy Act have no tendency to show that prior to such amendments Congress intended that claims based on ipso-facto covenants should not be provable.

On June 7 and 18, 1934, section 63 of the Bankruptcy Act was amended by adding three new subdivisions, one of which is as follows:

> "* * * (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates, pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

Petitioners and *amici curiae* in support of petitioners in their respective briefs argue that this amendment shows that prior to the amendment Congress intended that claims like the instant one should not be provable. The syllogism runs as follows:

Major premise: It was intended by Congress to change the then existing law by adding a new type of provable claim.

Minor premise: The instant type of claim is included within the definition of such new type of claim.

Conclusion: Therefore the instant claim was not provable prior thereto.

The difficulty with this line of reasoning again is that it fails to recognize, *as the 1934 amendment does,* the distinction between a claim for future rents, which the instant claim is not, and a claim for damages under a covenant in a lease. It is not necessary to resort to the Committee reports or complicated analysis to determine what new subsection (7) accomplishes. *First,* it adds a new type of claim —a claim for future rents as such which, prior to the amendment, was not provable, under the decision of this Court in the Manhattan Properties case. *Secondly,* it restricts the amount for which claims for future rents *and* claims for damages or indemnity under lease covenants may be allowed to a figure which does not exceed the rent reserved in the lease for the year succeeding the date of the surrender of the premises by the trustee.

It is submitted that the minor premise of the argument for petitioner is false. The instant claim is not included within the definition of the new type of claim. The instant claim could not be correctly included among "claims for damages respecting executory contracts including future rents." The contract upon which this claim is based is not executory at petition filed and the claim is not for future rents.

On the other hand, the instant claim (but for the proviso limiting the application of clause (7) to estates in which the time for filing claims had not expired) is included in the restriction limiting all claims by landlords, whether based on special covenants or not, to an amount not exceeding one year's rent. The difference in phraseology in the clause *permitting* a new type of claim and the clause *restricting* claims to an amount not exceeding one year's rent is highly

significant. The latter is obviously much broader than the former. If Congress had believed that all landlord's lease claims were covered by the permissive clause, it is submitted that the subject of the restrictive clause would not have been changed, and sub-section (7) would have been phrased substantially as follows:

> "(7) Claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation but future rent claims shall in no event be allowed in an amount exceeding * * *," etc.

The intent of Congress obviously was to permit claims for future rents (which this Court had held in the Manhattan Properties case to be not provable) to be proved along with claims based on special damage covenants (which several courts had intimated or held to be provable), and to limit both to an amount which would not exceed one year's rent.

In this connection there is an apparent inconsistency in the *amici curiae* brief in support of petitioner filed by Walter E. Hope and H. Struve Hensel. After stating that Congress intended to exclude the instant claim from the category of provable claims, *amici curiae* add (p. 7):

> "Such conclusion is clear and is important not only in respect of this claim but in respect of future bankruptcies. If the instant claim is not expunged, it will have been construed as outside the scope of new clause (7) of Section 63a and, therefore, all landlords using the mystical language here used will prove their claims in full. The intent of Congress to limit such claims in the future to a comparatively small amount will thus be evaded."

Yet on page 31 of the same brief the following statement appears:

> "One more thing should be noted. If, perchance, the instant claim is not included within clause (7), it is not provable in this or any other bankruptcy, past or future."

It is submitted that the proper construction of new subsection (7) of section 63 is that the instant claim is not included in the permissive clause of that section, but is included in the restrictive clause. The decision in this case will therefore not affect future bankruptcies.

Conclusion.

The decision of the Circuit Court of Appeals correctly applies section 63 of the Bankruptcy Act to the instant claim, and should therefore be affirmed.

Respectfully submitted,

THOMAS HUNT,
EARLE W. CARR,
Amici Curiae.